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Michael Faure and Kristel De Smedt

INTRODUCTION

In the last decade, the European Union was confronted with cases of severe damage to the environment caused by human activities. The accident in Romania where cyanide caused severe pollution of the Tisza river and the incident, a few years ago, near the Doñana nature reserve in the South of Spain, are only two examples of cases where human activities have resulted in substantial damage to the environment.

A growing interest in a harmonized environmental liability regime could therefore be observed at European level. Up to now, the environmental acquis does not provide in European legislation, either by directive or by regulation, for liability for damage caused to the environment. The member states of the European Union have established national environmental liability regimes that cover damage to persons and goods, and they have introduced laws to deal with liability for, and clean-up of, contaminated sites. However, according to the European Commission, these national regimes have not addressed the issue of liability for damage to nature. Damage to the environment has traditionally been seen as a 'public good' for which society as a whole should be responsible and bear the costs, rather than the individual perpetrator who actually caused the damage.

In February 2000, the European Commission issued the 'White Paper on Environmental Liability'[33]. This White Paper outlines the Commission's view on the key elements of a future environmental liability directive. The proposed regime should not only cover damage to persons and goods and contamination of sites, but also damage to nature. The proposed regime addresses especially those natural resources that are important for the conservation of biological diversity in the Community, namely the areas and species protected under the

[33] Commission of the European Communities, White Paper on Environmental Liability, *COM* (2000) 66 final, Brussels, 9 February 2000.

Natura 2000 network. With the introduction of liability for damage to nature as proposed in the White Paper, the Commission expects to bring about a change of attitude that should result in an increased level of prevention and precaution by European industry. Furthermore, the Commission estimates that a liability legislation would improve the implementation of existing EC environmental laws and the decontamination and the restoration of the environment[34]. On 30 July 2001, the Commission went a step further in the process towards a European liability directive by issuing a 'Working Document on the Prevention and Restoration of Significant Environmental Damage[35]'. The Working Document has been prepared for consultation by the member states and other interested parties and is to a large extent based on the environmental liability regime as proposed in the White Paper. Furthermore, there seems to be an increased emphasis on the duty to clean-up and prevention. Meanwhile, this working document has resulted in a formal draft directive. As this chapter was edited prior to this action, the arguments will mostly refer to the White Paper; however, the reasoning would be the same for the draft directive.

These developments at European level gave rise to this contribution. From a theoretical point of view we will examine whether harmonization of environmental liability legislation is desirable. The question that will be addressed in particular in this contribution is whether there are economic reasons for a harmonization of the environmental liability legislation in the European Union. To answer this question, the literature on the optimal level of regulation within federal systems will be used. It should be clear that this article does not deal with the question concerning the need for environmental regulation. That is undisputed. It should also be mentioned that our chapter does not provide an assessment on the proposed liability regime in the White Paper or the draft directive. It merely examines whether harmonization of environmental liability legislation in the European Union is desirable from a theoretical point of view and uses the White Paper as a case study. In that respect, the arguments brought forward by the Commission will be examined, in particular the traditional European argument of harmonization of conditions of competition, for the functioning of the internal market and compared with our theoretical framework.

The structure of the chapter is as follows: section 1 provides firstly a brief review of the foundations of European environmental policy and the background of the White Paper. Secondly, the arguments of the Commission for harmonizing environmental liability are presented. Then, section 2 discusses criteria for (de)centralization, using the literature on federalism. Section 3 applies this theory to the arguments brought forward by the Commission in

[34] White Paper, 5 (foreword), 7 (executive summary).

[35] The document is available on the website of DG Environment: http://europa.eu.int/comm/environment/liability/consulation.htm

its White Paper and section 4 completes this analysis by providing an interest-group perspective. Section 5 formulates some policy recommendations and a few concluding remarks will be made.

1. ENVIRONMENTAL LIABILITY AT EUROPEAN LEVEL

European Environmental Policy: Harmonization of Conditions of Competition

The origins of environmental legislation in Europe can be traced to the Paris Summit Meeting of the Heads of States in 1972. At that meeting, the member state leaders supported the idea of a common European environmental policy. By that time the EC had become more than a pure economic cooperation and was aware of social and environmental problems. Consequently, the European Union has drafted a series of Environmental Action Programmes, extending for a four- to five-year period. These programmes can be seen as political 'mission statements' and identify the goals and priorities for European environmental legislation. On that basis, the European Union has worked out a fairly elaborate body of environmental law, in particular by means of directives. On 24 January 2001, the Sixth Environmental Action Programme was published[36]. New environmental priorities include enlargement to the East and environmental liability legislation, which is the subject of this contribution.

The European Commission has given a variety of reasons for legislative action at the European level with respect to environmental law. Although most directives tend to have multiple reasons for their adoption[37], the most important are:

- The *transboundary nature of the environmental problem* to be dealt with. Several directives refer to the transboundary character of the pollution to argue for regulation at the European level. This is the case with, for instance, the directive dealing with the discharge of dangerous substances into the aquatic environment[38].
- The creation of *equal conditions of competition*. It is argued that harmonizing conditions of competition is necessary for the functioning of the

[36] Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on the sixth environmental action programme of the European Community 'Environment 2010: Our Future, Our Choice', COM (2001) 31 final, Brussels, 24 January 2001.

[37] For further details, see Van den Bergh, R., Faure, M. and Lefevere, J., 'The subsidiarity principle in European environmental law: an economic analysis', in Eide, E. and Van den Bergh, R. (eds), *Law and Economics of the Environment*, Oslo, Jurdisk Forlag, 1996, 128-31.

[38] Directive 76/464, Discharge of Dangerous Substances into the Aquatic Environment, *OJ*, 1976, L 129/23.

internal market. This argument, which is often referred to as the need to create a 'level playing field' for industry in Europe, is not only used in environmental law, but is advanced to harmonize any kind of legislation within Europe[39]. The directive on discharges of dangerous substances into the aquatic environment, mentioned above, was also based on this 'harmonization of conditions of competition' argument. It was argued that disparity between the provisions on discharge might create unequal conditions of competition and thus directly affect the functioning of the internal market[40].

- A third reason advanced for European action with respect to environmental matters can be called a purely 'ecological' one. There are a number of environmental directives that aim at the protection of the 'European environmental and cultural heritage and human health'. An example is the habitats directive[41].

The justifications mentioned above were also brought forward by the Commission in the White Paper in its argumentation in favour of a European environmental liability legislation. According to the subsidiarity principle, the 'community shall take action if and only in so far as the objectives of the proposed action cannot be sufficiently achieved by the member states and can, therefore, by reason of the scale or effects of the proposed action, be better achieved by the community[42]'. Therefore, the Commission had to justify in the White Paper that environmental liability could not effectively be dealt with by the member states. The Commission accordingly devotes special attention in the White Paper to the subsidiarity issue and the need for a harmonized environmental liability legislation[43].

In its paragraph on subsidiarity, the Commission states: 'the EC Treaty requires Community policy on the environment to contribute to preserving, protecting and improving the quality of the environment, and to protecting human health (Article 174(1)). This policy must also aim at a high level of

[39] Also the European Directive on Product Liability of 25 July 1985 was justified on the grounds that differing liability rules in the member states would hamper the conditions of competition. The considerations preceding the directive read: 'Whereas approximation of the laws of the member states concerning the liability of the producer for damage caused by the defectiveness of his products is necessary because the existing divergences may distort competition and affect the movement of goods within the common market . . .'.

[40] The same argument was made concerning other directives as well; see Van den Bergh, R., Faure, M. and Lefevere, J., 'The subsidiarity principle in European environmental law: an economic analysis,' in Eide, E. and Van den Bergh, R. (eds), *Law and Economics of the Environment*, Oslo, Jurdisk Forlag, 1996, 129.

[41] Directive 92/43, *OJ*, 192, L 206/7.

[42] Article 5 EC Treaty. See on the issue of subsidiarity also Kimber, C., 'A comparison of environmental federalism in the United States and the European Union', 54, *Maryland Law Review*, 1995, 321–26.

[43] White Paper, § 6, 28.

protection, taking into account the diversity of situations in the various regions of the Community. It shall be based on the precautionary principle and on the principle that preventive action should be taken, that environmental damage should as a priority be rectified at source and that the polluter should pay (Article 174(2))'.

According to the Commission, these principles are currently not being implemented in an optimal way throughout the Community. One reason the Commission provides for this is that there is a gap in most member states' liability regimes concerning bio-diversity damage. Moreover, national legislation cannot effectively cover issues of transboundary environmental damage within the Community, which may affect, among others, watercourses and habitats, many of which straddle frontiers. Therefore, the Commission concludes that an EC-wide regime is necessary in order to avoid inadequate solutions to transfrontier damage. An EC regime should aim at fixing the objectives and results, but the member states should have freedom to choose the ways and instruments to achieve these.

This chapter will attempt to critically address the possible meaning of these reasons for legislative action at the European level from an economic point of view. We will critically analyse these arguments of the Commission to justify European competences in the remainder of this chapter. Let us first turn to the goal and contents of the White Paper on environmental liability.

White Paper on Environmental Liability

Purpose and history

In February 2000, the European Commission issued the long-awaited White Paper on Environmental Liability[44]. In the White Paper the Commission describes its view on the key elements of a future environmental liability directive. In the Commission's opinion, such a directive would improve the implementation of the EC Treaty's grand principles of environmental policy incorporated in the EC Treaty (Article 174(2)), the preventive, precautionary and polluter pays principles. Furthermore it would improve the enforcement of existing EC environmental laws, ensure decontamination and restoration of the environment, better integration of the environment into other policy areas and improved functioning of the internal market. Liability should enhance incentives for more responsible behaviour by firms and thus exert a preventive effect[45].

[44] Commission of the European Communities, White Paper on Environmental Liability, *COM* (2000) 66 final, Brussels, 9 February 2000. See also L. Bergkamp, 'The White Paper on environmental liability', *European Environmental Law Review* (EELR), April 2000, 105 and P.E.A. Bierbooms and E.H.P. Brans, 'Het EU Witboek Milieuaansprakelijkheid: de vage contouren van een toekomstig aansprakelijkheidsregime', *Milieu & Recht*, July/augustus 2000 no 7/8.

[45] White Paper, executive summary, 7.

It took the Commission more than a decade before a proposal on an Environmental Liability Directive could be presented[46]. In 1989, the Commission proposed a directive dealing only with liability for damage caused by waste[47]; however, the proposal was quickly abandoned. The Commission subsequently started to examine a broader liability regime covering environmental damage. In 1993, the Commission published a Green Paper on Remedying Environmental Damage[48], which presented some of the broad notions on which an EC liability regime could be based and which was intended to initiate a public debate. For a short time, the Commission played with the idea of the EC joining the 1993 Council of Europe Lugano Convention, but this approach was rejected. According to the Commission the main differences between a Community directive and Community accession to the Lugano Convention are that the scope of Community action can be better delimited and the regime for bio-diversity damage can be better elaborated, in accordance with the relevant Community legislation. Both differences result in more legal certainty than provided by the Lugano Convention. However, even if the Community does not accede to the Lugano Convention, the latter could provide an important source of inspiration for a future Community directive[49].

In November 1997, the Commission issued a working paper on environmental liability[50]. Compared with this paper, the White Paper finally published in February 2000 is somewhat less ambitious and leaves more issues open for further debate. Although the publication of a White Paper is already a more formal step towards EU legislation, it does not provide any guarantee that a directive will be finally adopted. Nevertheless, for this contribution, we will take the provisions of the White Paper as given and use it as a tool to test the economic theory of federalism. Indeed, as we indicated in the introduction, the White Paper has meanwhile resulted in a working document and a subsequent draft directive. However, since the White Paper concerns the most interesting, arguments from the perspective of the economies of federalism, we will use this White Paper as a basis for our analysis.

[46] Bergkamp L., note above, 105 to 106 and P.E.A. Bierbooms and E.H.P. Brans.

[47] Proposal for a Directive on civil liability for damage caused by waste, *OJ* C 251/3 (1989); as amended COM (91) final *OJ* C 192/6 (23.07.91).

[48] Green Paper on Remedying Environmental Damage, *COM* (93) 47 final, Brussels, 14 May 1993.

[49] White Paper, § 5.1, 25.

[50] Commission of the European Communities, Working Paper on Environmental Liability, Brussels, 17 November 1997. For a comment on this draft see e.g. Bergkamp, L., 'A future environmental liability regime', *European Environmental Law Review*, 1998, 200–204 and De Vries, C., 'Community action on environmental liability', in Wiggers-Rust, L. and Deketelaere, K. (eds.) *Aansprakelijkheid voor milieuschade en financiële zekerheid*, Die Keure-Vermande, 1999, 141–47.

Main principles of the White Paper

The Commission suggests that an EC liability regime should be based on Article 175 of the Treaty. In accordance also with the subsidiarity and proportionality principles, the directive should be a framework regime containing essential minimum requirements[51]. This framework directive could be completed over time with other elements that might appear necessary on the basis of the experience gathered with its application during the initial period, called the *step-by-step approach.*

The main features of the proposed liability regime that the Commission outlines in its White Paper are:

- A regime that would not have retroactive effects (application to future damage only). The exclusion of the retroactivity is justified by reasons of legal certainty and legitimate expectation.
- Since the protection of health is also an important environmental objective, and for reasons of coherence, the proposed EC regime should cover both traditional damage (harm to health and property) and environmental damage (site contamination and damage to bio-diversity), which is currently not sufficiently covered by the member states.
- The Commission proposes that contaminated sites and traditional damage are only to be covered if caused by an EC-regulated hazardous or potentially hazardous activity. Damage to bio-diversity will only be covered if the area or species are protected by the Natura 2000 network. These protected areas are or have to be designated by the member states under the Wild Birds Directive of 1979 and the Habitats Directive of 1992. Since many habitats and waterways straddle frontiers between member states, the EC regime would also apply to transboundary damage.
- The EC regime should be based on strict liability (this means that no fault by the polluter is required), when damage is caused by inherently dangerous activities, and fault-based liability for damage to bio-diversity caused by a non-dangerous activity.

[51] For comments on this White Paper see e.g. Betlem, G., 'Commission adopts White Paper on environmental liability', *TMA*, 2000, 58–60 and Bierbooms, P.F.A. and Brans, E.H.P., 'Het EU witboek milieu-aansprakelijkheid: de vage contouren van een toekomstig aansprakelijkheidsregime', *Milieu & Recht*, 2000, 182–88 and Rice, P., 'From Lugano to Brussels via Arhus: environmental liability white paper published', *Environmental Liability*, 2000, 39–45. For the reason that with respect to some issues (e.g. causation or defences) no firm decisions have been taken yet Rehbinder is rather critical of the White Paper. He hopes for 'major improvement of the proposal' (see Rehbinder, E., 'Towards a community environmental liability regime: the Commission's White Paper on environmental liability', *Environmental Liability*, 2000, 85–96); others are critical with respect to the proposals on action rights of NGO's, Hunter, R., 'European Commission White Paper proposals on NGO rights of action: wrongful rights of action', *Tijdschrift voor Milieu-aansprakelijkheid*, 2000, 125–26.

In summary, the White Paper suggests that the most appropriate option for a harmonized environmental liability regime would be a framework directive providing for strict liability for damage caused by EC-regulated dangerous activities, with defences, covering both traditional and environmental damage, and fault-based liability for damage to bio-diversity caused by non-dangerous activities.

Arguments for harmonization advanced in the White Paper

According to the subsidiarity principle (art. 5 of the Treaty), in areas where the EC does not have exclusive competence for jurisdiction, such as environment and hence environmental liability, the EC has to justify why it is in a better position than the member states to set policy or legislation on a specific issue. Thorough review of the White Paper reveals six arguments for harmonization brought forward by the Commission in its introduction, its paragraphs 3, 5 and 6[52]. After discussion of the literature on federalism in section 2, the arguments made will be reviewed in section 3. Let us first reiterate, in more detail[53], the arguments which the Commission uses to justify European action with respect to environmental liability.

Transfrontier damage

In the introduction to the White Paper, the Commission already indicates that harmonization should be accepted under the subsidiarity principle, as the member states cannot adequately deal with transboundary environmental pollution. Paragraph 6 of the White Paper dealing specifically with the subsidiarity issue states that a directive would be necessary 'to avoid inadequate solutions to transfrontier damage'[54]. The Commission firmly states that national legislation cannot effectively cover transboundary environmental damage as various watercourses and protected habitats cross the borders of the member states.

Polluter pays principle

Paragraph three deals with the advantages and hence the necessity of a European environmental liability legislation. First, the polluter pays principle is brought forward. In the Commission's view, the proposed liability regime would realize the three grand environmental principles enshrined in Art 174 (2) of the EC Treaty: the polluter pays, precautionary and preventive principles. In particular, liability is viewed as a way of making the polluter pay. 'If

[52] Bergkamp, L., 'The White Paper on environmental liability', *European Environmental Law Review*, 2000, 106.

[53] The arguments were briefly introduced above.

[54] White Paper, § 6, 28.

polluters need to pay for damage caused, they will cut back pollution up to the point where the marginal cost of abatement exceeds the compensation avoided'[55]. The European Commission obviously refers to the economic theory of cost internalization. As a firm will always try to minimize its total costs, forcing the polluter to internalize the costs of pollution resulting from production, obliging him to pay for the damage would result in more precaution and hence in prevention of environmental harm. Furthermore the Commission believes that it may encourage investment in research and development (R&D) for improving knowledge and technologies.

Decontamination and restoration of the environment and better implementation

In its plea for an EC environmental liability regime, the Commission raises two further arguments. A liability legislation would ensure decontamination and restoration of the environment and boost the implementation of, and compliance with, EC environmental legislation[56].

Creating a level playing field

As the next argument, the Commission explains that an EC regime 'may contribute to creating a level playing field in the internal market'[57]. From this statement, it seems that the Commission believes that differences in the various national regimes may result in cost differences and thus in competitive advantages for companies in member states with lax environmental liability regimes.

Principle of equal treatment

Finally, an argument that is rather hidden in paragraph 5.2, deals with the principle of equal treatment. Following the argument of transfrontier damage, the Commission argues that a regime dealing exclusively with cross-border harm 'would leave a serious gap where liability for bio-diversity damage is concerned'. This could have as a consequence that purely national and cross-border cases will be treated differently, which could possibly violate the principle of equal treatment developed by the European Court of Justice[58].

We will now immediately turn to the economic approach by addressing the question: what does economics generally teach about the necessity of harmonization? The remainder of the chapter will deal with the question whether harmonization of environmental liability is necessary from an economic point

[55] White Paper, § 3.1, 14.
[56] White Paper, §§ 3.2–3.3, 14.
[57] White Paper, § 3.5, 15.
[58] White Paper, § 5.2, 25.

of view. We will first present the economic criteria of centralization and apply these to environmental legislation generally. These criteria have been developed in the context of the discussion concerning (de)centralization. Then we will apply these criteria to the issue of environmental liability by applying them to the just mentioned arguments the European Commission advanced in the White Paper to defend its intervention in the area of environmental liability.

2. IS HARMONIZATION NEEDED?: CRITERIA FOR (DE)CENTRALIZATION

Bottom-up Federalism of Tiebout

The question whether regulation should be organized at central (European or federal) level or at a more decentralized level (or, to put it in a more balanced way, what kind of regulations should be set at which level) has been addressed in the economics of federalism[59]. The starting point for the analysis is usually the theory of Tiebout about the optimal provision of local public goods[60]. Tiebout argued that when people with the same preferences cluster together in communities competition between local authorities will, under certain restrictive conditions, lead to allocative efficiency. If there are for example in one community citizens with a high preference for sporting facilities and in another one a majority of citizens with a preference for opera, the first community will probably construct sporting facilities, whereas the second will probably provide an opera house. If someone living in the second community would prefer sporting facilities instead of the opera house, he could then move to the first community, which apparently provides services that better suit his preferences. The idea is that well-informed citizens will move to the community that provides the local services that are best adapted to their personal preferences. Through this so-called 'voting with the feet' competition between local authorities will lead citizens to cluster together according to their preferences. In practice one notices that different communities do indeed offer a variety of different

[59] This chapter is based on earlier research, see Faure, M., 'Regulatory competition versus harmonization in EU environmental law', in Esty, D. and Geradin, D. (eds), *Regulatory Competition and Economic Integration*, Oxford, Oxford University Press, 2001, 263–86 and see Faure, M., 'Product liability and product safety in Europe: harmonization or differentiation?', *Kyklos*, vol. 53, 2000, 467–508.

[60] Tiebout, C. (1956), 'A pure theory of local government expenditures', *Journal of Political Economy*, 60, 415–24. For a discussion of this theory, see Rose-Ackerman, S., *Rethinking the Progressive Agenda: the Reform of the American Regulatory State*, 1992, 169–70.

services. The idea is that the citizen can influence this provision of local public goods either by influencing the decision-making (vote) or by moving (exit).

This basic idea applies not only to community services, but also, for example, to fiscal decisions[61], environmental choices[62] and even legal rules. It has been argued by Van den Bergh (1994) that competition between legislators will lead to legal systems competing with each other to provide legislation that corresponds best to the preferences of their citizens. Also Ogus (1999) argued that the various lawmakers in the nation-states would create competitive markets for the supply of law.

The idea therefore is that in an optimal world citizens will cluster together in states that provide legal rules that correspond to their preferences. Well-informed citizens, who may be dissatisfied with the legislation provided, could move (voting with the feet) to the community that provides legislation that corresponds best to their preferences. This idea, assuming that those different legal systems offer different legal rules thus explains the variety and differences between the legal systems (Van den Bergh 1998). Moreover, it also shows that differences between the various legal rules of different countries should not necessarily be judged as negative, as is often the case in Europe today. The idea of competing legal systems can probably best be seen 'in action' in international private law where actors can chose the legal systems that best suits their needs in a choice of law regime[63].

Obviously, assuming that competition between legal orders leads to allocative efficiency in the provision of legal rules works only if certain conditions are met. One condition is that citizens have adequate information on the contents of the legal rules provided by the various legislators, in order to be able to make an informed choice. In addition, exit if often costly, so people may stay even if the (legal) regime does not suit their needs optimally[64]. Moreover, a location decision is obviously made under the influence of a set

[61] See e.g. Inman, R.P. and Rubinfeld, D.L., 'The EMU and fiscal policy in the new European community, an issue for economic federalism', *International Review of Law and Economics*, vol. 14, 1994, 147–62; Kirchgässner, G. and Pommerehne, W.W., 'Low-cost decisions as a challenge to public choice', *Public Choice*, vol. 77, 1993, 107–16 and Oates, W.E., *Fiscal Federalism*, New York, Harcourt, 1972.

[62] See Oates, W.E. and Schwab, R., 'Economic competition among jurisdiction: efficiency enhancing or distortion inducing?', *Journal of Public Economics*, 1988, vol. 35, 333–54.

[63] Although the choice for a particular legal regime may not always be related to the quality of the legal system but, for example, to the quality of the court or arbitration system. The latter explains, according to Ogus, A., 'Competition between national legal systems: a contribution of economic analysis to comparative law', *International and Comparative Law Quarterly*, vol. 48, 1999, 408, the popularity of English law in choice of law clauses in contracts.

[64] As Ogus, A., 'Competition between national legal systems: a contribution of economic analysis to comparative law', *International and Comparative Law Quarterly*, vol. 48, 1999, 407, states there should be no barriers to the freedom of establishment and to the movement of capital.

of criteria, whereby the legal regime may not be decisive[65]. Usually the job location and residence are so important that in reality there is often little left for people to choose[66]. Finally, as we will discuss below, this system of competition between legal orders works only if the decisions in one legal order have no external effects on others.

In economic literature, this Tiebout model is used to argue that, from an economic point of view, decentralization should be the starting point, since competition between legislators will lead to allocative efficiency. Van den Bergh (1994) uses this theory as well to provide criteria for centralization/decentralization within the European Union. Taking Tiebout as a starting point and assuming that competition between decentralized legislators will lead to an optimal provision of legal rules, the central question is: why centralize?

Van den Bergh therefore criticizes a part of the current discussion in the European legal literature, which seems to focus on the question why there should be decentralization (referred to by Van den Bergh as 'top-down federalization'). According to economic theory, that is the wrong question. Starting from Tiebout's model, there is reason to believe in what Van den Bergh calls a 'bottom-up federalization', assuming that in principle the local level is optimal, since the local level has the best information on local problems and on the preferences of citizens. Only when there is a good reason, should decision-making be moved to a higher level. Economic theory has indeed suggested that there may be a variety of reasons why the local level is not best suited to take decisions and where central decision-making can lead to more efficient results.

These criteria for centralization will now be applied to environmental liability. In particular, these criteria will provide information on whether a harmonized European environmental liability regime might be required.

Reasons for Centralization

Transboundary character of the externality

The Tiebout argument in favour of competition between local communities obviously works only if the problem to be regulated is indeed merely local.

[65] That is one of the reasons why Frey, B., 'FOCJ: competitive governments for Europe', *International Review of Law and Economics*, vol. 16, 1996, 315–27 and Frey, B. and Eichenberger, R., 'To harmonize or to compete? That's not the question', *Journal of Public Economics*, 1996, vol. 60, 441–58, argue in favour of FOCJ: the choice for one legal or institutional regime should not be exclusive; there may be 'overlapping' jurisdictions depending upon the different functions.

[66] Rose-Ackerman, S., *Rethinking the Progressive Agenda: the Reform of the American Regulatory State*, New York, Free Press, 1992, 169.

Once it is established that the problem to be regulated has a transboundary character, there may be an economics-of-scale argument to shift powers to a higher legal order that has competence to deal with the externality over a larger territory. This corresponds with the basic insight that if the problem to regulate crosses the borders of competence of the regulatory authority, the decision-making power should be shifted to a higher regulatory level, preferably to an authority which has jurisdiction over a territory large enough to adequately deal with the problem[67].

This argument in favour of centralization could play a role with respect to environmental problems. It can be argued that these are certainly often transboundary[68]. The transboundary character of an externality is, within the European context, obviously an important argument for decision-making at the European level. Indeed, many environmental problems cross national borders. A great many of the environmental directives fit into this economic criterion for community action. These include the regulation on the transboundary shipment of waste[69], as well as many other directives, which regulate pollution of a transboundary character[70].

Nevertheless the most important reason for community action with respect to the environment is therefore probably not the often-stated argument of the harmonization of conditions of competition, but simply the transboundary character of the pollution problem to be regulated. Many of the environmental directives indeed deal with pollution problems, which cross the borders of one single member state. They can therefore be justified under this first economic criterion. This does obviously not necessarily imply that the contents of every directive on this point has been efficient, nor that the instruments used to cure transboundary pollution have always been optimal.

However, some have warned that the argument that centralized powers are necessary to deal with transboundary problems should not be accepted too

[67] Compare: Ogus, A., 'Competition between national legal systems: a contribution of economic analysis to comparative law', *International and Comparative Law Quarterly*, vol. 48, 1999, 414 and Kimber, C., 'A comparison of environmental federalism in the United States and the European Union', 54, *Maryland Law Review*, 1995; Esty, D., *Revitalizing Environmental Federalism*, 95 *Michigan Law Review*, 1996, 625 and Rose-Ackerman, S., *Rethinking the Progressive Agenda: the Reform of the American Regulatory State*, New York, Free Press, 1992, 164–65. See also Arcuri, A., 'Controlling environmental risk in Europe: the complementary role of an EC environmental liability regime', *Tijdschrift voor Milieuaansprakelijkheid*, 2001, 41–42.

[68] See equally Oates, W. and Schwab, R., 'Economic competition among jurisdiction: efficiency enhancing or distortion inducing?', *Journal of Public Economics*, 1988, vol. 35, who also argue that as long as the effects of pollutants are confined within the borders of the relavant jurisdictions, local authorities will make socially optimal decisions of environmental quality.

[69] Regulation 259/93 of 1 February 1993, *OJ*, 1993, L 30.

[70] This is certainly the case as well for Directive 76/464 on the Discharge of Dangerous Substances into the Aquatic Environment. For other examples, see Van den Bergh, R., Faure, M. and Lefevere, J., 131–32.

easily. First, Esty and Geradin have powerfully argued against an 'all or nothing' approach, meaning either all powers with the local authorities or shifting all powers to the central level. They have argued that the transboundary pollution problems can be dealt with via other legal instruments than centralization, in other words via instruments which do not involve a change of the national environmental laws of a particular country[71]. One possibility is the external application of (domestic) high-standard country laws. Another one is the national enforcement of domestic laws with cross-border monitoring. In other words: the transboundary character of the externality may be an argument for cooperation, not necessarily for homogeneity of legal rules. However, Esty and Geradin admit that these alternative approaches have serious limitations as well and might not be effective remedies in all cases[72].

Second, Cohen argued that Coasean bargaining between the polluting and the victim state may lead to negotiated agreements between them[73]. Therefore, Cohen argues that there is no a priori reason to centralize regulatory decision-making[74]. There might, however, be several reasons why the ideal solution from Coase's world might not be possible to solve transboundary pollution problems, e.g. in case of transboundary rivers such as the Rhine or the Meuse. Coase assumes that property rights are clearly defined[75]. Although there are some indications in international environmental law on this point, it might not be certain what the legal rule is: right to pollute or polluter pays. This uncertainty concerning the assignment of property rights might endanger negotiations. In addition, adequate information is needed both on the consequences of pollution and on the possible abatement techniques[76] and moreover, there may be no strategic behaviour. Also, parties need to have the possibility to enforce a negotiated agreement. In that respect the EC framework might have several

[71] See Esty, D. and Geradin, D., 'Environmental protection and international competitiveness. A conceptual framework', 32/3 *Journal of World Trade*, 1998, 5–46 and see Esty, D. and Geradin, D., 'Market access, competitiveness and harmonization: environmental protection in regional trade agreements', 21 *Harvard Environmental Law Review*, 1997, 265–336 in which they provide an interesting overview of the various legal instruments to deal with harmonization and apply this in the NAFTA and in the European context. See also Trebilcock, M. and Howse, R., 'Trade liberalization and regulatory diversity, reconciling competitive markets with competitive politics', *European Journal of Law and Economics*, vol. 6, 1998, 5–37.

[72] Esty, D. and Geradin, D., 'Environmental protection and international competitiveness. A conceptual framework', 32/3 *Journal of World Trade*, 1998, 34–35.

[73] See also Van den Bergh, R., 'Economics in a legal strait-jacket: the difficult reception of economic analysis in European law' (paper presented at the workshop Empirical Research and Legal Realism. Setting the Agenda, Haifa, 6–9 June 1999).

[74] Cohen, M., 'Commentary', in Eide, E. and Van den Bergh, R. (eds), *Law and Economics of the Environment*, Oslo, Juridisk Forlag, 1996, 167–71.

[75] Which Cohen, M., 'Commentary', in Eide, E. and Van den Bergh, R. (eds), *Law and Economics of the Environment*, Oslo, Juridisk Forlag, 1996, 168–69, mentions as well.

[76] Cohen, M., 'Commentary', in Eide, E. and Van den Bergh, R. (eds), *Law and Economics of the Environment*, Oslo, Juridisk Forlag, 1996, 168.

advantages. The EC offers an institutional framework that provides legal instruments to enforce an agreement. Moreover, the EC regulatory framework might fix the property rights. Also, the fact that member states within the EC framework are repeat players (an injurer today may be a victim tomorrow) may eliminate the risk of strategic behaviour. If one also looks at the practice of transboundary pollution in Europe, one may argue that indeed the EC approach has achieved far better results so far than all the attempts towards bilateral agreements. EC directives on (transboundary) pollution of waters provided Dutch victims of Belgian pollution of the river Meuse with a powerful tool to force the Belgians to pollution abatement[77], a result which could probably never have been achieved through the long-lasting negotiations between the two countries. Thus, the EC has undoubtedly played an important role as far as providing remedies against transboundary pollution is concerned.

However, Van den Bergh has demonstrated that in some cases, more particularly in the area of private law, European law cannot be considered an effective remedy to the interstate externality problem[78]. In some cases European law goes further than is needed to cure transboundary externalities; in other cases less far-reaching legal instruments than total harmonization could be used to remedy the problem[79]. There is, in other words, always the risk that the cure may be worse than the disease. The first issue relates to the problem that European Directives often cover both local and community wide pollution, without making a distinction between regional and interstate pollution[80]. The second point is that in some cases transboundary externalities may also be internalized by national law. The simple fact of transboundary effects is therefore not sufficient to justify European lawmaking[81]. Nevertheless, there can indeed be cases where one can hold that decentralized legal rule making will not be able to remedy the transboundary externality.

Indeed, in some cases the EC considers the transboundary character of a

[77] See Pâques, M., 'Effet direct du droit communautaire, interprétation conforme et responsabilité de l'Etat en général et en matière d'environnement', in Van Dunné, J. (ed.), *Non-Point Source River Pollution; The Case of the River Meuse*, Den Haag–London, Kluwer Law International, 1996, 89–139. See for the case of the river Rhine: Van Dunné, J., *Transboundary Pollution and Liability: the Case of the River Rhine*, Rotterdam, Erasmus University Institute of Environmental Damages, 1991.

[78] Van den Bergh, R., 'Subsidiarity as an economic demarcation principle and the emergence of European private law', 5 *Maastricht Journal of European and Comparative Law*, 1998, 143.

[79] Van den Bergh, R., 'Subsidiarity as an economic demarcation principle and the emergence of European private law', 5 *Maastricht Journal of European and Comparative Law*, 1998, 144–45.

[80] Van den Bergh, R., 'Economics in a legal strait-jacket: the difficult reception of economic analysis in European Law' (paper presented at the workshop Empirical Research and Legal Realism. Setting the Agenda, Haifa, 6–9 June 1999) 10.

[81] Van den Bergh, R., 'Subsidiarity as an economic demarcation principle and the emergence of European private law', 5 *Maastricht Journal of European and Comparative Law*, 1998, 144–45.

problem as a sufficient justification for centralized rule making without differentiating between local and transboundary pollution[82]. Moreover, a great deal of the environmental directives also deal with relatively 'local' problems that do not cross national borders. This seems to be the case as well for environmental liability. Many pollution cases giving rise to liability are confined within the borders of one country. Moreover, even if there is transboundary pollution other remedies could be applied (e.g. via international private law) that do not go as far as total harmonization. Note that this 'transboundary externality' argument is a totally different one in a product liability case, since the likelihood of products affecting international trade is obviously quite large[83]. For environmental liability there would only be a case for centralization if the central rules were to apply only to transboundary pollution and even this question would arise only if this problem could not be remedied by less far-reaching means. However, the European environmental liability regime as proposed in the White Paper supposedly applies to 'damage to biodiversity', which is not necessarily transboundary. The question therefore arises whether other economic reasons can be found for European environmental liability legislation in those cases where the effects of pollutants are confined within the borders of the relevant member states, for example in the case of soil pollution[84].

Race for the bottom

There exist a second economic argument for a centralized regulation of environmental problems. The risk of destructive competition, known as a 'race for the bottom' between countries that could emerge to attract foreign investments with low environmental standards. As a result of this, a prisoners' dilemma could arise whereby countries would fail to enact or enforce efficient legislation. This would mean that local governments would compete with lenient environmental legislation to attract industry[85]. The result would be an overall reduction of environmental quality below efficient levels. This should correspond with the traditional game-theoretical result that prisoners' dilemmas create inefficiencies. Centralization could be advanced as a remedy for these prisoners' dilemmas.

This 'race for the bottom' argument, that competition among jurisdictions

[82] See for instance directive 74/464 which regulates discharges of dangerous substances into the aquatic environment for both transboundary rivers and local pounds.

[83] See R.M. Ackerman, 'Tort law and federalism: whatever happened to devolution?', *Yale Law and Policy Review*, 1996, 429–63 and G.T. Schwartz, 'Considering the proper federal role in American Tort Law', 38 *Arizona Law Review*, 1996, 917–51.

[84] The regime as proposed in the White Paper should typically apply to soil pollution.

[85] Compare Rose-Ackerman, S., *Rethinking the Progressive Agenda: the Reform of the American Regulatory State*, New York, Free Press, 1992, 166–70.

for economic activity will be 'destructive', corresponds to some extent with the earlier mentioned Commission argument in the White Paper that the creation of harmonized conditions of competition is necessary to avoid trade distortions. The trade argument is traditionally used to harmonize legislation of the member states in a variety of areas. Simply stated, the argument is that complying with legislation imposes costs on industry. If legislation is different, these costs would therefore differ as well and conditions of competition within the common market would not be equal. The argument apparently assumes that total equality of conditions of competition is necessary for the functioning of the common market. 'Levelling the playing field' for European industry remains the central message.

The 'race for the bottom' argument has had several supporters as well as opponents in North American scholarship. Law and economics scholars tend to stress the benefits of competition between states and point to the dangers of centralization[86], whereas some legal scholars tend to attach greater belief to the 'race for the bottom' rationale for centralization in environmental matters[87]. In Europe these issues are rarely discussed in the context of the 'race for the bottom' but in the European community dogma of 'levelling the playing field to avoid distortions of competition'. This somewhat confuses the debate. The 'harmonization of conditions of competition' argument could either be interpreted narrowly in 'race for the bottom' terms or more broadly as a general argument to harmonize all kinds of rules and standards. The latter is the usual interpretation in Europe. Let us look at both interpretations more closely and see how they relate to the area of environmental liability.

Risk of the bottom versus common market

The traditional European argument claims that any difference in legislation between the member states might endanger the conditions of competition and therefore justifies harmonization of legal rules. This argument seems particularly weak. From an economic point of view, the mere fact that conditions of competition differ does not necessarily create a 'race for the bottom' risk. There can be differences in marketing conditions for a variety of reasons, and if the conditions of competition were indeed totally equal, as the argument assumes, there would also be no trade according to the theory of specialization.

[86] See especially with applications to environmental law Revesz, R., 'Rehabilitating interstate competition: rethinking the race for the bottom rational for federal environmental regulation', 67, *New York University Law Review*, 1992, 1210–54 and Revesz, R., 'Federalism and interstate environmental externalities', 144 *University of Pennsylvania Law Review*, 1996, 2341–2416.

[87] See Esty, D. and Geradin, D., note 39, 'Environmental protection and international competitiveness. A conceptual framework', 32/3 *Journal of World Trade*, 1998 and Esty, D. and Geradin, D., 'Market access, competitiveness and harmonization: environmental protection in regional trade agreements', 21 *Harvard Environmental Law Review*, 1997.

Also, Europe has developed an elaborate set of rules, which guarantee – *inter alia* – a free flow of products and services[88] and thus contribute to market integration without the necessity of harmonizing all rules and standards[89]. In this respect one can think of the case law of the European Court of Justice with respect to the free movement of goods versus environmental protection[90]. This shows that the goal of market integration can be achieved via (other) less far-reaching instruments than total harmonization[91] which can equally remove barriers to trade.

Hence, one should make a distinction between the political ideal of creating one common market in Europe on the one hand and the (economic) 'race to the bottom' argument on the other hand[92]. This political goal of market integration may as such be questioned on economic grounds[93] and may justify the need for rules aiming at a reduction of trade restrictions such as, for example, a harmonization of product standards[94]. The problem in environmental law is that initiatives in that area also aim at a harmonization of process standards 'to harmonize conditions of competition'. That seems questionable on efficiency grounds[95]. What can be said about this 'harmonization of conditions of competition' argument either in its 'race for the bottom' or in its 'Common Market' version?

From an economic perspective, differences in the conditions of competition only pose a problem if it is clear that environmental costs would be considerably different between the member states and that these differences would lead

[88] See the articles 28–30 of the Treaty (formerly articles 30–36).

[89] See generally on the potential conflict between free trade and environmental protection, Esty, D. (1999), 'Economic integration and the environment', in Vig, N. and Axelrod, R. (eds), *The Global Environment*, Washington, DC: CQ Press, 190–209.

[90] For an overview of this case law see Lefevere, J. and Faure, M., 'Introduction to European environmental law', in Kegels, T. (ed.), *Shipping Law Faces Europe: European Policy Competition and Environment*, Brussel, Maklu, 1995, 93–107 and Trebilcock, M. and Howse, R., 1998, 21–28.

[91] See also Esty, D. and Geradin, D., 'Environmental protection and international competitiveness. A conceptual framework', 32/3 *Journal of World Trade*, 1998, 296–99 and Ogus, A., *Regulation, Legal Form and Economic Theory*, Oxford, Clarendon Press, 1994, 177–79.

[92] See also Revesz, R., 'Environmental regulation in federal systems' in *Yearbook of European Environmental Law* (2000), at 24 to 27, who equally argues that these are separate points which should be distinguished.

[93] See Van den Bergh, R., 'Economics in a legal strait-jacket: the difficult reception of economic analysis in European law' (paper presented at the workshop Empirical Research and Legal Realism. Setting the Agenda, Haifa, 6–9 June 1999).

[94] These were the result of directives issued as a consequence of the so-called 'Single Market Initiative'. See Vogel, D. *Trading Up: Consumer and Environmental Regulation in the Global Economy*, Cambridge, Harvard University Press, 1995. See on the need to harmonize product safety Faure, M. 'Product liability and product safety in Europe: harmonization or differentiation, *Kyklos*', vol. 53, 2000, 467–508.

[95] This is also criticized by Revesz, R.

to relocation of firms to the member state with the lowest standards[96]. In that case, the so-called race for the bottom argument, in environmental cases referred to as the 'pollution haven' hypothesis, might be an argument in favour of centralization[97]. The question therefore arises whether there is empirical evidence that states can indeed attract industry by lenient environmental standards.

Empirical evidence of pollution havens

Empirical evidence to uphold this 'race for the bottom' rationale is rather weak. Repetto argues that pollution control costs are only a minor fraction of the total sales of manufacturing industries[98]. Moreover, Jaffe/Peterson/Portney/Stavins[99] argued that empirical evidence shows that the effects of environmental regulations are 'either small, statistically insignificant or not robust to tests of model specification'. They argue that the stringency of environmental regulations might have some effect on new firms in their decision to locate for the first time[100], but that this will not induce existing firms to relocate. They equally argue that other criteria such as tax levels, public services and the unionization of labour force have a much more significant impact on the location decision than environmental regulation. Later this empirical evidence has been somewhat contradicted by Xing/Kolstad[101], who argue that the laxity of environmental regulations in a host country is a significant determinant of foreign direct investment by the US chemical industry. The more lax the regulations, the more likely the country is to attract foreign investment, so Xing/Kolstad argue. Although this somewhat weakens the evidence presented by Jaffe/Peterson/Portney/Stavins[102] as far as the location of new firms outside the US is concerned, it does not contradict the finding that existing firms will not relocate because of the stringncy of environmental regulations.

This material, therefore, weakens the prisoner's dilemma argument.

[96] See equally Revesz, R., who argues that given the weaknesses of the 'harmonization of conditions of competition' argument 'it is not surprising that recent European scholarship has sought to recharacterize the quest for harmonization in race to the bottom terms'.

[97] Although Esty and Geradin have rightly pointed to the fact that a whole variety of legal instruments exists which may remedy the problem, whereby the total harmonization of standards would be the most far-reaching (Esty, D. and Geradin, D., 'Environmental protection and international competitiveness. A conceptual framework', 32/3 *Journal of World Trade*, 1998, 282–94).

[98] Repetto, R., *Trade and Sustainable Development*, UNEP, Environment and Trade Series.

[99] Jaffe, A., S. Portney, and R. Stavins, 'Environmental regulation and the competitiveness of US manufacturing: what does the evidence tell us?', 33 *Journal of Economic Literature*, 1995, 132–63.

[100] See Esty, D. and Geradin, D., 'Environmental protection and international competitiveness. A conceptual framework', 32/3 *Journal of World Trade*, 1998, 12–15.

[101] Xing, Y. and Kolstad, C., 'Do lax environmental regulations attract foreign investment' 16–95 (working paper in Economics, University of California, 1995).

[102] See White Paper, § 5.1, 25.

Moreover, it has also been argued that as far as environmental standards are concerned, it is not at all clear that there will be a 'race for the bottom'. There is also some evidence that member states precisely try to strive for high environmental standards, even if this puts extra costs or burdens on their industry. Some countries may therefore be more involved in a 'race for the top' instead of a 'race for the bottom'[103]. One could also question whether European law is at all able to remedy a real 'race for the bottom' risk, given the enforcement deficit.

All these arguments apply to the area of environmental liability as well. It is doubtful that within Europe member states would be able to engage in a game in which they would strive for low-level environmental liability in order to attract industry. There is no proof of such a destructive competition towards lower liability standards and this risk is, moreover, not very realistic. Indeed, as indicated, one can doubt whether environmental liability plays a significant role in attracting or repulsing business to or from a given state. Other elements may be far more important than the level of environmental liability in location decisions of businesses. Moreover, if environmental liability were to have any effect as far as the 'race for the bottom' is concerned, it is even more likely that states would wish to protect victims of environmental pollution instead of corporate interests. Indeed, a lenient environmental liability legislation may well run counter to the states' interests since it would limit the possibilities, for example, recovering of soil clean-up costs from liable polluters. If there is any effect at all one can therefore expect a 'race for the top' rather than a 'race for the bottom' in the area of environmental liability. This would enable states to recover, for example, costs for clean-up of (domestically) polluted soils, also from foreign polluters.

Levelling the playing field

Let us now turn to the other – legal – interpretations of the 'race for the bottom' argument. It should be stressed that this European argument that markets shall be distorted without a harmonization of conditions of competition is not only constantly repeated in a stereotypical way, but its validity is hardly ever questioned. The argument as it is usually presented in Europe, cannot, as was stated above, be fitted into the economic criteria for centralization, since it suggests

[103] See Van den Bergh, R., Faure, M. and Lefevere, J., 'The Subsidiarity Principle in European environmental law: an economic analysis,' in Eide, E. and Van den Bergh, R. (eds), *Law and Economics of the Environment*, Oslo, Jurdisk Forlag, 1996, 141–42. Ogus argues that there may be benefits to firms to be located in a high-standard member state, since this may generate technological improvements and thus competitive advantages; that may explain 'race for the top' (Ogus, A., 'Competition between national legal systems: a contribution of economic analysis to comparative law', *International and Comparative Law Quarterly*, vol. 48, 1999, 415). See, generally, Vogel, D., *Trading Up: Consumer and Environmental Regulation in the Global Economy*, Cambridge, Harvard University Press, 1995 and Trebilcock, M. and Howse, R., 1998, 13–14.

that removing any difference in legal systems would be necessary to eliminate the 'race for the bottom' risk, which is neither supported by economic theory, nor by empirical evidence. Also, even if one were to take the (political) 'common market' goal as starting point and environmental regulations were to be harmonized on that ground, this would still not create a level playing field since differences in, for example, energy sources, access to raw materials and atmospheric conditions will still lead to diverging marketing conditions[104].

There is, in addition, a strong counter-argument, in that there are many examples showing that economic market integration is possible (without the distortions predicted by the 'race for the bottom' argument) with differentiated legal orders. Public-choice scholars have often advanced the Swiss federal model as an example where economic market integration goes hand in hand with differentiated legal systems[105]. It is apparently possible to create a common market without a total harmonization of all legal rules and standards[106].

These arguments therefore weaken the prisoner's dilemma argument in the field of environmental law both in its 'race to the bottom' form and in the (disguised) way it is presented in the European debate. The European argument that any difference in legal rules between the member states would endanger market integration and that therefore a harmonization of law is needed in order to harmonize conditions of competition[107] is too general, too unbalanced and not supported by economic theory. Differences between legal systems of member states may, from an economic point of view, constitute a problem if this were to result in an inefficient 'race for the bottom'. But the empirical evidence available suggests that this may not be a serious risk in the environmental field. Even if differences in the stringency of environmental law exist between member states, this will generally not lead companies to relocate to 'pollution havens' within Europe. The least one can argue is that if the European Commission were to use a 'race for the bottom' rationale for centralization, it should prove that without centralization in the specific field a risk of destructive competition would emerge[108]. The debate in Europe has,

[104] See Van den Bergh, R., 'Economics in a legal strait-jacket: the difficult reception of economic analysis in European Law' (paper presented at the workshop Empirical Research and Legal Realism. Setting the Agenda, Haifa, 6–9 June 1999) , 10.

[105] Frey, B., 'Direct Democracy: Politico-Economic Lessons from Switzerland', 84 *American Economic Review*, 1994, 338–42.

[106] See equally Revesz, R.

[107] See the formulation in the preamble to the Products Liability Directive.

[108] In that case there may seriously be a valid argument for an intervention by Brussels. Compare – in the US context – the remark by Rose-Ackerman, S., *Rethinking the Progressive Agenda*, 173: 'If state and local laws seem designed to protect local business rather than reflect genuine differences in tastes across jurisdiction, the federal government should take a hard look to determine the possible interference with interstate commerce'.

so far, never focused on that question[109], since it was always argued that any harmonization of legal rules was necessary to achieve market integration, which obviously confuses the debate.

The same applies for the area of environmental liability. It is indeed very possible to create a common market without a total harmonization of all legal rules. The goal of market integration should not necessarily be achieved via this far-reaching instrument of total harmonization. This would only justify, for example, general safety standards that aim at avoiding pointless incompatibilities which could create barriers to trade and distortions of competition within the internal market. The latter argument can, however, not justify a harmonization of rules of private law such as environmental liability. Finally, attempts which have been undertaken so far to harmonize rules of private law, for example, in the area of product liability, have not proven to be able to achieve a total harmonization of marketing conditions (see Faure, 2000).

Transaction costs

There may, however, be one final economic argument in favour of harmonization, based on transaction costs reduction[110]. This argument is often advanced by European legal scholars pleading for harmonization of private law in Europe, and is based on the argument that differences in legal systems are very complex and only serves Brussels law firms[111]. This argument cannot be examined in detail here[112]. It is obviously too simple to state that a harmonized legal system is always more efficient than differentiated legal rules because of the transaction costs savings inherent in harmonized rules[113]. This argument neglects the fact that there are substantial benefits from differentiation whereby legislation can be adapted to the preferences of individuals (Mendelsohn, 1986, 301). Moreover, given the differences between the legal systems (and legal cultures) in Europe the costs of harmonization may be huge – if not prohibitive – as well[114]. The crucial question therefore is whether the possible transaction costs savings of harmonization outweigh the benefits of differentiated legal rules. There is little empirical evidence to support the statement that transaction

[109] See equally Esty, D. and Geradin, D., who argue that the risk of a regulatory 'race to the bottom' for environmental reasons has not been a major issue in the EC (Esty, D. and Geradin, D., 'Environmental protection and international competitiveness', 32/3 *Journal of World Trade*, 1998, 308).

[110] A somewhat related but different argument relates to economics and diseconomics of scale in administration, see Rose-Ackerman, S., *Rethinking the Progressive Agenda*, New York, Free Press, 1992, 165–66.

[111] This is one of the arguments made by the Danish scholar Lando in favour of harmonized private law (Lando, 1993, 473–74).

[112] It is further developed and criticized in a recent paper by Van den Bergh (1998).

[113] Compare Rose-Ackerman (1992, 172) who argues that uniform federal regulation may reduce search costs and tends to produce a more stable and predictable jurisprudence.

[114] That point has been made especially by Legrand (1997, 111).

costs savings could justify a European harmonization of all kinds of legal rules. Moreover, the transaction cost savings are likely to be relatively small (Van den Bergh, 1998, note 68, 146–48).

If one addresses the question whether the regime proposed in the White Paper could achieve a reduction of transaction costs one would have to assess whether it can create a uniform regime and provide a legal certainty which would reduce transaction costs. That is highly doubtful.

Indeed, there is one particular point of worry concerning the regime proposed in the White Paper which may endanger the uniformity and increase transaction costs. This has to do with the balanced approach chosen in the White Paper which may make a future liability regime highly complex. A scheme provided in the White Paper itself[115] makes clear that the proposed regime is not only well balanced, but also very complex. Indeed, as the summary shows, the applicable regime will depend upon the type of damage (traditional damage, contaminated sites or damage to bio-diversity) but in addition upon the type of activity (dangerous or not). Moreover, the White Paper argues that it focuses on damage to bio-diversity, since most existing member states' environmental liability regimes would not cover that type of damage. The question, however, arises whether that is generally true; member states certainly have rules on traditional damage and contaminated sites.

This entails therefore a risk of increased legal complexity, which could lead to cases whereby different legal regimes (different European and national regimes) apply to various types of damage, resulting from a single pollution case. That would obviously create legal uncertainty and may hence endanger the reduction of transaction costs. To a large extent, this is due to the fact that the White Paper has not addressed the question how the different regimes proposed should be combined if, for example, a non-dangerous activity causes damage to the soil, to human health and to bio-diversity as well. A future regime should definitely better clarify how these (European and national) rules apply to specific cases if one really wishes to reduce transaction costs.

The transaction costs argument could, however, play a role to justify the so-called negative harmonization, which aims at a co-ordination of, for example, product standards to prevent states from hindering a free flow of products and services (see Vogel, 1995, pp. 52–55). This type of cooperation between States can reduce transaction costs, but does not necessitate a homogenization of process standards, which is often the goal in environmental law.

The conclusion therefore is that the economic arguments to harmonize environmental rules with respect to problems which are not transboundary is relatively weak. Nevertheless, many European directives deal with (e.g.

[115] Which we have included in an annex.

drinking water or bathing water) problems which are not typically transboundary and for which the European competence is therefore difficult to fit into the economic framework. The question, however, arises whether a non-economic argument can be advanced for regulation at the European level.

European heritage argument

Can an argument be found to protect the environment at the European level as such? The protection of habitats and entire ecosystems comes to mind. This is of particular importance since the White Paper precisely focuses on damage to bio-diversity. A traditional example is the question whether there should be any European jurisdiction to protect an imaginary turtle which has, say, only one habitat, which is in Greece. The traditional economic argument in such a case would be that since the problem is merely local, the Greek population should decide whether or not to protect the Greek turtle. An attempt in the direction of an economic argument for European competence has been made by Wils, who classifies the protection of endangered species as justified by the fact that this endangerment causes 'psychic spill-overs' (Wils, 1994, pp. 85–90). The argument then goes that the endangerment of the Greek turtle would also harm the interests of, for example, a Dutch citizen living in Maastricht who would suffer a psychic spill-over from the fact that the Greek turtle would be endangered[116]. According to this view, the externality would be considered transboundary (although the turtle only lives in Greece) and there would, again, be an economic rationale for centralization[117]. Maybe this argument still holds for turtles or for Italian nature parks, whose well-being also affects other European citizens[118]. But what about a European directive, regulating liability of soil pollution by a certain plant and regulating clean-up standards?

Differences according to preferences

In the case above on soil pollution, centralization seems, at first sight, contrary to basic economic logic. From an economic point of view, the environmental clean-up standards to be provided could differ according to differing preferences of citizens[119]. Again, from an economic point of view, there is no reason for centralization if the externalities are local and no prisoners' dilemmas exist. This economic argument in favour of differentiation

[116] Compare Esty, D., 'The health of ecosystems to which we have no physical connection may enter directly into our utility calculus'.

[117] Compare Ogus (1999, p. 418), who argues that harmonization may be justified if foreigners derive disutility from observing the plight of victims in the offending state.

[118] But then the Greek should probably be compensated for the extra costs involved in this European habitat protection (compare Rose-Ackerman, S., 42–43).

[119] Developed by Ogus (1994, pp. 25–30) and more generally in Ogus (1999, p. 413)

according to the preferences of citizens is not only valid for the question whether or not the Greek turtle should be protected at the European level[120]. It is also valid for the whole body of environmental law, and even for environmental liability standards. This corresponds with the Tiebout framework of competition between legal orders where citizens are free to choose the environmental quality that corresponds optimally with their preferences. The consequence of this economic approach is that it should be for Greece to decide, for example, to prefer economic development over environmental quality[121]. A consequence of this economic argument whereby citizens choose a level of environmental protection according to their preference should obviously be that the environmental quality would vary according to the individual preferences of citizens. This argument is also used at the normative level in the US where there are increasingly pleas in favour of standard-setting by the states rather than by a federal environmental agency (Schoenbrod, 1996). This *economic* argument therefore leads to an environmental federalism in which environmental quality between member states could differ as long as there are no transboundary effects and no 'race for the bottom' risks[122]. For areas related to environmental liability such as soil pollution this would mean that states would be free to choose their own clean-up and liability standards.

Guaranteeing a basic environmental quality

There is, however, an important legal or policy argument that could lead to centralization. This has to do with the idea of guaranteeing all European citizens a similar environmental quality. This is sometimes referred to as the protection of the 'European environmental and cultural heritage and human health'. If this argument is accepted at the policy level, it could be used to harmonize environmental quality. It is, however, important to note that the reason for centralization in such a case would then not be the economic need of market integration, but the ecological desire to guarantee all citizens within the Union a similar, or at least basic, environmental quality. The consequence would then be that, contrary to economic logic, it would not be the preferences of citizens that would prevail, but the policy desire to provide one basic

[120] To be very specific: this chapter is not concerned with the normative question whether or not the Greek turtle deserves protection. It is concerned only with the question whether such a decision should be taken in Greece or at the European Community level.

[121] Again, this is not to say that Greece should not protect the environment, but only to argue that, from an economic point of view, this is not a question that Brussels should be concerned about.

[122] However, since firms are in a competitive environment a member state which chooses to impose a high level of protection (and thus high costs on firms) will have to compensate for this with, for example, lower taxes on wages in order to avoid the exit of business, see, Rose-Ackerman, S., 41.

environmental quality in Europe[123]. This corresponds with the point made by Ogus that the preferences of citizens for lower standards at lower costs may sometimes be overruled if it is held that these low standards would infringe widely held perceptions of human rights[124]. In the environmental context this point could take the form of guaranteeing all citizens a basic environmental quality[125].

Again this chapter does not argue at the normative level that this would not be a valid argument for centralization, but it is important to stress that if this argument for centralization is used, it is only for ecological (or policy) reasons, not for economic reasons, that one would strive for harmonization of environmental quality. A serious problem with this 'European heritage' argument is that it may be valid to defend, for example, a European-wide protection of, say, the Coliseum in Rome[126], but less so to guarantee a minimum environmental quality. In that case it would make more sense to strive for a Europe-wide minimum level of public health, which is not the case today.

But if this 'European heritage' reason for centralization in order to guarantee all European citizens a basic environmental quality is accepted, there are several consequences. If externalities are merely local and no 'race for the bottom' risks exist, it is hard to find an economic rationale for centralization. At the policy level, truly ecological reasons can be advanced for centralization to guarantee a similar environmental quality throughout the union. This could take the form of minimum standards which should be achieved after the clean-up of polluted soils. But then this ecological argument, not the 'harmonization of conditions of competition argument', has to be advanced to justify, for example, the guarantee of a minimum environmental quality in Greece[127].

[123] Compare Esty, D., who argues in favour of global environmental norms which should represent a behavioural minimum. More critically is Revesz, R., 'Federalism and regulation: some generalizations', in D. Esty and D. Geradin (eds), *Regulatory Competition and Economic Integration, Comparative Perspectives*, 2001, 3–29.

[124] Rights may, in this instance, justifiably 'trump efficiency', see Ogus, A., 'Competition between national legal systems: a contribution of economic analysis to comparative law', *International and Comparative Law Quarterly*, vol. 48, 1999, 418. See also Cohen, M., 'Commentary', in Eide, E. and Van den Bergh, R. (eds), *Law and Economics of the Environment*, Oslo, Juridisk Forlag, 1996, 170 who calls for minimum quality standards at centralized level for reasons of 'equity, justice, or pure paternalism' and Stewart, R., who states that geographically uniform standards ensure every individual a minimum healthy environment even though such uniformity is economically inefficient.

[125] See explictly Kimber: 'An analogy may be drawn here with human rights. It is arguable that certain minimum standards of environmental protection ought to be achieved by all countries and regions, particularly if one accepts that the environment is the common heritage of us all' (1995, 1690).

[126] But there it is the transboundary ('psychic') spill-over which justifies European intervention.

[127] If the idea is accepted that it is for ecological reasons (harmonizing environmental quality in the Union) that centralization is needed, this has consequences for environmental standard setting. This point is further developed in Faure (2001)

Balance

In this section, the economic literature on federalism was used to provide a critical look at some aspects of the harmonization of environmental law in general and environmental liability in particular. The economic arguments were also compared to the arguments advanced in favour of harmonization in Europe. First we sought to provide an economic analysis of the traditional European argument that conditions of competition should be harmonized to 'create a level playing field'. This argument is too general to fit into the economic criteria for centralization. This economic literature provides for a balanced answer with respect to the types of subject matters that should be regulated at the centralized or at the decentralized level. This shows that the questions concerning centralization/harmonization cannot be answered in black or white statements. From the economic literature it appears that there are very few economic reasons for harmonization of environmental liability legislation. Such an argument would only exist if domestic polluters could externalize environmental damage to 'foreign victims'. However, other remedies may be available to cure interstate pollution without the need to harmonize liability. A second economic reason for centralization would exist if it were established that states could attract industry with lenient environmental liability standards. That is, however, very unlikely since states would to the contrary enact legislation to protect domestic victims of environmental pollution with high-standard environmental liability legislation. There could be transaction costs savings of uniform environmental liability law if a directive were able to create legal certainty and achieve full harmonization, which is highly doubtful with the regime proposed in the White Paper.

Nevertheless, some non-economic arguments, for example based on ecological grounds, such as the guarantee of a high environmental quality in the European Union, might be legitimate arguments for a certain amount of harmonization and centralization. Therefore, the question that should be asked is what the goal of harmonization of environmental law should be. If European environmental policy is, as is sometimes stated, to promote uniform environmental quality within the Union, this can be reached by fixing a harmonized environmental quality, to be enforced by the Commission, but with differentiated legislation, for example, on environmental liability. If the goal of environmental policy is to equalize conditions of competition, hence purely economic, it should be examined whether harmonization of environmental liability legislation really improves equal competition, or whether it serves some industries that lobbied to erect artificial barriers to entry. Harmonization in such cases might not be desirable. That issue will be addressed below when we examine the importance of special interest If European environmental policy pursues ecological reasons, a certain degree of harmonization may

sometimes well be justified. However encouraging 'green behaviour' combined with clear clean-up standards for the member states might be more effective than punishment by a liability legislation.

3. EUROPEAN ENVIRONMENTAL LIABILITY REASSESSED

Section 3 closes the circle and goes back to the starting point of this chapter, the Commission's White Paper on Environmental liability. So far we found that there are relatively few economic arguments in favour of environmental liability rules (see 'Balance' in the previous section) centralized. However, we have already indicated that, within the framework of the subsidiarity discussion, the European Commission also advanced arguments to justify a European-wide environmental liability regime. These arguments put forward by the Commission for an EC environmental liability regime (see above) will now be confronted with the economic criteria for centralization presented above.

Transfrontier Damage

The first argument of the Commission dealt with transboundary damage. It is held in the White Paper that member states cannot effectively address cross-border pollution. Indeed, as the literature on federalism indicates, the Tiebout model will not yield efficient results if cross-border externalities are not adequately addressed (Faure, 1998). In the case of cross-border externalities, the EC, not the member states should have jurisdiction (Bergkamp, 2000, p. 107). This cross-border rationale, however, provides an explanation for only part of the EC environmental legislation, as the EC acknowledges implicitly: 'the Union's current policies extend far beyond air and water quality to include the protection of soils, habitats and fauna and flora, and the conservation of wild birds[128]'.

However, if cross-border harm is a serious problem in the EC but member states can adequately deal with pollution within their borders, then according to the subsidiarity principle, an EC liability regime would only be justified for cross-border environmental harm instead of an overall liability regime. This would result in a so-called 'transboundary only' regime. In this respect, environmental liability differs from other areas of tort like product liability. Products cross borders all the time, but habitats stay where they are (Bergkamp, 2000, p. 107). Moreover, according to Bergkamp, cross-border

[128] (www.europa.eu.int/pol/env.info.en.htm)

externalities by themselves do not necessarily justify a harmonized liability regime: 'additional regulatory initiatives or more effective enforcement mechanisms might cure these as well' (Bergkamp, 2000, p. 107). Indeed, case law in many member states has developed in order to allow an extra-territorial application of domestic law on cross-border pollution. These jurisprudential evolutions may thus remedy cross border externalities without the need for a total harmonization of environmental liability. Therefore, transboundary environmental pollution can occur in certain cases in the EU. However, this argument by itself is not sufficient for a fully harmonized liability regime in the EU. Other remedies may solve this problem. Moreover, even if harmonization were to be considered a preferred legal instrument, it could only justify a European 'transboundary only' regime and not a total harmonization.

Polluter Pays Principle

An argument which seems to be very important for the Commission is the polluter pays principle. The Commission believes that environmental liability may encourage investment in research and development (R&D) for improving knowledge and technologies. What can be said about this argument from an economic perspective?

First, it should be made clear that the polluter pays principle as such does not explain why environmental regulation should be issued at the European level to promote this principle. Indeed, in this respect we should refer to the whole range of regulations that already exist today in the member states. The Commission offers no evidence that the liability regime as proposed will generate more incentives for prevention than the existing national and European liability and regulatory schemes (Bergkamp, 2000, p. 108).

Second, the White Paper's statement that the liability legislation will promote R&D is not supported by empirical evidence either (Bergkamp, 2000, p. 108). According to economic theory, if no adequate intellectual property rights are available, R&D will to a large extent be a 'public good' which private parties will not produce, or produce insufficiently. The reason is that once the investment is made, all competitors will benefit without having to make any research investments. This is the well-known free-rider problem. Furthermore, the firms might have incentives not to invest in R&D because in the future the outcome may become minimum standard (Kolstad, 2000).

Third, the polluter pays principle does not resolve the question as to whether costs should be internalized through 'ex ante' regulatory requirements, rather than through 'ex post' liability rules. Nor does it resolve controversies like forcing innocent or marginal polluters to pay for damage caused by their predecessors, or that any polluter has to pay for unforeseeable or tolerable damage. Liability is a way of making the polluter pay, but it might be a

very unattractive option. In short, the polluter principle does not require or justify an environmental liability regime (Faure, 1996, 90 and Bergkamp, 2000, 108). But, most importantly, the principle as such can, at least from an economic perspective, not justify the need for European action.

Decontamination and Restoration of the Environment

The Commission repeatedly expresses its expectations that a liability regime would encourage decontamination and restoration of the environment and improve the implementation of, and compliance with, EC environmental legislation[129]. This consists in fact of a variety of sub-arguments. First, it is argued that a European regime would encourage the restoration of the environment.

Although one could only cheer this result, these expectations are probably more idealistic than realistic. Liability is neither a sufficient nor a necessary condition for pursuing these two objectives[130]. Bergkamp points out that the argument that an EC liability regime is necessary to ensure the restoration of damaged habitats is not sufficient, as member states are already required to do so[131]. He argues that, if the objective of an environmental liability legislation is ensuring the clean-up of contaminated land then EC law should solely impose an obligation on member states to reach that objective. By issuing such a directive, the member states would be free to choose the instruments they will use. This may, but does not have to, involve additional liability rules. According to Bergkamp, 'liability is not the right instrument to promote compliance with environmental regulations, unless it is used as a sanction for damage caused by non-compliance and the regulatory compliance defence is fully recognized'[132].

First we have already pointed out that there are few economic reasons that can be advanced for a harmonized environmental liability regime. However, we indicated that European action might be brought, although for non-economic reasons. If the Commission refers, by the 'decontamination and restoration argument', to the desire of guaranteeing all European citizens a similar (high) environmental quality, this objective might be fulfilled by other means than environmental liability. Whereas liability punishes industry, market-oriented approaches encouraging R&D in greening the industry (by funding), combined with clear clean-up standards for the member states, might be more effective.

[129] White Paper, § 3.1–3.2, 14.

[130] L. Bergkamp, 'The White Paper on environmental liability', *European Environmental Law Review*, April 2000, 108.

[131] Council Directive 92/43 on the conservation of natural habitats and wild fauna and flora, *OJ*, L 206 , 7.

[132] Bergkamp L., 'The White Paper on environmental liability', *European Environmental Law Review*, April 2000, 108.

Second, the argument has been made that by using liability law the implementation of EC environmental legislation can be promoted. But, as we have just indicated, European law provides for a wide variety of other legal instruments to stimulate implementation of European law. Liability rules can only play a minor role to that effect.

Third, it should be stressed that the Commission apparently does not propose a European-wide harmonized environmental liability regime, but links the EC liability regime with existing EC environmental legislation. Moreover, the Commission specifically focuses the proposed regime on damage to bio-diversity since most existing member states' environmental liability regimes do not cover this type of damage[133].

From a subsidiarity perspective this approach seems to be rather balanced in that it focuses merely on those areas where member states have apparently not enacted legislation and limits itself largely to liability resulting from activities regulated under EC environmental law. However, several objections could be made to this approach as well. First, the mere fact that member states would not have enacted legislation with respect to a particular subject matter is obviously, under subsidiarity, no justification for European intervention. Second, it simply does not seem correct that the White Paper would merely deal with areas where the member states have not yet enacted legislation. The White Paper for example deals extensively with soil pollution. This issue is also dealt with in the legislation of many member states. Finally, although the balanced approach of not opting for a total harmonization can be defended (although it would have been better to limit the European regime to transboundary damage), a disadvantage is obviously that it has become so complex that the differences in conditions of competition will obviously remain in existence. This shows once more that any approach which chooses to combine European and member state legislation can never lead to a 'level playing field', so that argument cannot justify European competences.

Creation of a Level Playing Field

Although the Commission does not place the argument for the creation of a level playing field in first place in its White Paper, it probably will be one of the main arguments for harmonization. The literature on federalism, however, clarified that the risk of a 'race to the bottom' is very unlikely to occur in the EU. Even if differences in the stringency of environmental law exist between

[133] For a critical perspective of the European competence with respect to environmental liability see Niezen, G.J., 'Aansprakelijkheid voor milieuschade in de Europese Unie' in *Ongebonden Recht Bedrijven*, Kluwer, 2000, 165–67 and 168–69.

member states, this will generally not lead companies to relocate to 'pollution havens' within Europe. This argument has been extensively dealt with above.

Moreover, full harmonization cannot be justified either in order to create 'equal conditions of competition'. The reasons have been discussed above. The Commission for its part also admits that there is no clear evidence of such advantages. Studies carried out at the request of the Commission have shown that the effect of liability regimes on competitiveness remain unclear[134]. When the Commission discusses the economic impact of environmental liability at EC level, it states itself in the White Paper that 'no significant impact is discernible and the environmental liability regimes in place in member states . . . have not led to any significant competitiveness problems'[135].

If that is the case, one may wonder how an EC directive can be justified on the grounds of levelling the playing field. Moreover, the White Paper suggest that the directive would be based on Article 175 of the Treaty. This would mean, according to the wording of Article 175 and 176, that member states would be authorized to go beyond the directive's scope and broaden it[136]. Therefore competitiveness reasons cannot justify EC intervention. Bergkamp rightly indicates that any competition distortions that may exist would be likely to continue to persist even after the proposed liability regime is implemented[137].

Moreover, we have indicated that the regime proposed in the White Paper is so complex that it can never have the effect of creating a 'level playing field'. The argument for the creation of a level playing field is therefore not sufficient to allow for a harmonized European environmental liability regime.

Principle of Equal Treatment

The final argument deals with the principle of equal treatment. The equal treatment is discussed in the White Paper *in the context of the transboundary externalities* argument. In the literature it has been suggested that if interstate externalities are a reason for centralization, the European directive should not necessarily cover both local and community-wide pollution[138]. This idea of a

[134] 'Economic aspects of liability and joint compensation systems for remedying environmental damage, summary report', ERM Economics, London, March 1996 (annex to the White Paper).

[135] White Paper, § 7, 29.

[136] Article 176 provides that 'the protective measures adopted pursuant to Article 175 shall not prevent any Member State from maintaining or introducing more stringent protective measures. Such measures must be compatible with this Treaty. They shall be notified to the Commission'.

[137] Bergkamp L., 'The White Paper on environmental liability', *European Environmental Law Review*, April 2000, 106.

[138] Van den Bergh suggested that a distinction should be made between regional and interstate pollution (Van den Bergh, 'Economics in a legal strait-jacket: the difficult reception of economic analysis in European law' (paper presented at the workshop Empirical Research and Legal Realism. Setting the Agenda, Haifa, 6–9 June 1999, 10).

'transboundary only' regime was rejected, since this could lead to inequalities in treatment of victims in member states depending on whether they were victim of transboundary or local pollution[139]. Nevertheless this White Paper on environmental liability shows that the Commission now (the White Paper was issued on 9 February 2000) seems to be aware of the arguments advanced in economic literature in favour of (de)centralization and at least discusses them.

Strikingly, the White Paper – at least implicitly – discusses the criteria advanced by economic analysis for centralization at the European level (more particularly the transboundary character of environmental pollution and the 'harmonisation of conditions of competition' arguments) and rightly points to the fact that these arguments would theoretically lead to a preference for a 'transboundary only' regime. The White Paper, however, rejects this approach on the basis of equality arguments.

At this point, it seems that when referring to equality, the Commission no longer argues within the scope of the subsidiarity principle. It simply argues for uniformity[140]. As we will argue in the next chapter, this argument could fit into the public choice theory which holds that industry in heavily regulated (and probably polluted) areas lobbies (supported by green NGOs) to force their very stringent environmental regulations upon other member states that might not need such stringent measures. In that way, this industry might erect artificial barriers to entry.

However, the subsidiarity principle has been included in the EC Treaty precisely to prevent Community action based mainly on a desire for uniformity or equal treatment. As it is not proven that uniformity is necessary for the member states in order to deal effectively with environmental damage, there is no need for full harmonization. The equality argument against a 'transboundary only' regime is therefore not very convincing, neither from an economic, nor from a legal perspective.

4. PUBLIC CHOICE CONSIDERATION

So far we have discussed the economic criteria for (de)centralization, applying these to the area of environmental liability (section 2). We compared these to the arguments advanced by the European Commission to justify European competences, as these were advanced in the White Paper (section 3).

We concluded that relatively few economic arguments can be found to

[139] White Paper, 25–26.

[140] Bergkamp L., 'The White Paper on environmental liability', *European Environmental Law Review*, April 2000, 107.

justify centralization in the area of environmental liability. This was only the case for transboundary pollution and even then the question arises whether the same result cannot be reached through different, less far-reaching legal instruments than total harmonization.

Nevertheless, we found that there are apparently strong forces in Brussels striving for a European environmental liability regime, at least for damage to bio-diversity. To some extent this can still be explained on public-interest grounds since we also indicated that non-economic, ecological arguments could be advanced, for example, to strive for a minimum quality of clean-up for polluted soils. However, public choice scholars have thought that there is always a risk that regulation in fact serves the interests of particular pressure groups.

Indeed, another non-economic reason why the European Union would harmonize liability legislation can be found in the public choice theory. Public choice theory deals with the role of interest groups in legislation. Lobbying activities at the European level are extremely strong. With respect to environmental standard-setting, intensive rent-seeking behaviour by interest groups can be identified. In Europe, industry may be confronted at state level with 'green' non-governmental organizations (NGOs), whereas these countervailing powers might have less force in Brussels. Moreover, the lack of transparency in the decision-making process, which the European Union is often reproached for, will stimulate European industry to engage in serious lobbying efforts.

The lobbying does not necessarily have to result in lower environmental standards. In particular cases, special-interest groups, representing industry, might, understandably, lobby in favour of harmonization at a higher level of environmental protection[141]. Interest groups in areas which are already heavily regulated may have incentives to extend their strict (national) regulations to the European level, forcing foreign competitors to follow the same strict regulation with which they already comply. The result is that industry will lobby to erect artificial barriers to entry. In addition, green NGOs will be pleased with this lobby and will obviously support the demand to transfer strict national standards to a European standard[142]. Thus, industry in heavily regulated (and probably polluted) areas can (supported by green NGOs) force their very stringent emission-limit values upon their (southern) competitors, although these member states probably would not need these

[141] See also Esty, D. and Geradin, D., 'Market access, competitiveness and harmonization: environmental protection in regional trade agreements', 21 *Harvard Environmental Law Review*,1997.

[142] These 'alliances' between environmentalists and domestic producers are also discussed by David Vogel: *Trading Up: Consumer and Environmental Regulation in the Global Economy*, Cambridge, Harvard University Press, 1995, 52–55.

stringent environmental limit values if the policy goal were one of reaching uniform environmental quality.

Thus it becomes clear that the 'harmonization of conditions of competition' argument is used to serve the interests of industries in heavily regulated areas to erect barriers to entry. Hence, environmental law can be used to limit market entry and environmental law is abused to serve private-interest goals. This leads to the conclusion that the 'harmonization of conditions of competition' argument, as presented in European rhetoric, can even be problematic, from both the economic and ecological points of view, and in fact serves the interests of industrial groups in heavily regulated areas[143]. It can be in their interests that 'conditions of competition' are actually harmonized. It is not clear yet whether the White Paper on environmental liability should be considered as an attempt by interest groups to create barriers to entry. One problem is that the contents of the White Paper are still rather vague and specific details of the regime (e.g. clean-up standards) are not known yet.

The Commission argued that the white paper deals with a topic, damage to bio-diversity, which has not been the subject yet of legislation in the member states. That is, however, only partially the case. Most member states may indeed lack specific rules, for example, concerning the way damage to natural habitats has to be calculated. But the White Paper also addressed the area of soil pollution, for which extensive regulations exist in most member states. Thus, theoretically, one could still run the risk that industry in member states with stringent soil clean-up regulations would strive for centralization, creating a barrier to entry for competitors from countries where these strict standards do not yet apply.

It is too early to assess whether the desire to create a European environmental liability regime in fact serves the interests of industry. One should, however, always be aware of the fact that the risk that centralization can be abused to create barriers to entry may always appear in any attempt towards centralization.

5. POLICY RECOMMENDATIONS AND CONCLUSIONS

This contribution has tried to examine from a theoretical point of view whether there are economic reasons for a harmonization of environmental liability legislation in the European Union. As a case study, the arguments

[143] This is not to say that there is no risk of regulatory capture resulting in inefficient standards at the level of the member states; compare (in the US context) Rose-Ackerman, S., *Rethinking the Progressive Agenda,* New York, Free Press, 1992, 166 and 173. However, in Europe, it is especially the untransparent Brussels bureaucracy which is feared from a public choice perspective.

brought forward by the Commission in its White Paper on Environmental liability were examined, in particular the traditional European argument that a harmonization of conditions of competition would be necessary in order to create a level playing field. The literature on federalism makes clear that there are very few economic arguments to justify a harmonized liability regulation in the European Union. Even though there may be an argument for centralization in cases of transboundary pollution, this does not justify a total harmonization. Non-economic arguments such as ecological reasons may justify a certain degree of harmonization. However encouraging 'green behaviour' combined with clear clean-up standards for the member states might be more effective than deterrence through liability legislation.

Therefore, the basic question the European Union should ask is what the goal of harmonization of environmental liability should be. European policy-makers should think more thoroughly about the reasons for harmonization or at least about the rhetoric used to justify such a harmonization. More particularly they should realize that they can either opt for the ecological goal of uniform environmental quality or for the goal of harmonizing legislation, but not for both at the same time. One has the impression at the present time that the instruments chosen (harmonization of legislation) do not always match the expressed goals (harmonization of environmental quality). Apparently European legal scholars are coming round to this view to this insight as well. Recently De Witte argued that Europe should now leave the – wrong – rhetoric about harmonization of conditions of competition aside and should clearly state that it wants to achieve a minimum quality for its citizens[144].

Several conclusions can be drawn from the analyses in the previous sections. First, from the analyses it appears that the arguments advanced by the Commission to justify European competences for the area of environmental liability are either weak or insufficient to justify a harmonized liability legislation in Europe. Therefore, if Europe is concerned with ecological goals and wishes to achieve a similar environmental quality in the Union, it should set harmonized target standards. Europe should, in other words, be interested in the end product, being the environmental quality to be reached. This also assumes that Europe would merely receive powerful tools to monitor whether this environmental quality is actually achieved (which is still a major weakness today[145])

[144] De Witte, B., 'Carving out a place for European Union law in the legal universe' (paper presented at the conference Ius Commune in a World Context, Maastricht 15 April 1999, forthcoming in the *Maastricht Journal of European and Comparative Law*).

[145] In Europe there is no enforcement agency which possesses police powers, as this is considered by member states to violate their sovereignty (Kimber, C., 'A comparison of environmental federalism in the United States and the European Union', 54, *Maryland Law Review*, 1995, 1685; Ogus, A., *Regulation, Legal Form and Economic Theory*, Oxford: Clarendon Press, 1994, 212–13 and Pfander, J., 72–75.

and to enforce the target in case of non compliance. The fact that it is difficult to monitor the actual quality of the environment may also explain why Europe long preferred directives containing emission standards whereby the Commission only checked whether there was a correct formal implementation in the legislation of the member states.

Second, in order to reach this uniform environmental quality, environmental liability legislation can be differentiated. This differentiation is efficient as long as the benefits of differentiation outweigh the (administrative) costs.

Third, from this it follows that the idea of harmonization of conditions of competition, as it is pronounced as a goal for European environmental action, is wrong for several reasons. It is wrong for economic reasons, since a full harmonization of conditions of competition is not needed to reach the economic goals of the Treaty; it is equally wrong for ecological reasons, since it does not allow for the goal of uniform environmental quality. The conclusion may only be different if externalities are transboundary or there is a serious risk of a run to pollution havens. Those may be arguments to harmonize liability legislation, but then it should be clear that this may not lead to an equal environmental quality. In that case European policymakers will have to make a choice between 'levelling the playing field' through harmonized legislation or ecological harmonization of environmental quality. One way to (partially) reconcile these goals is to shift powers to Brussels because of the transboundary character of the externality, but to recognize differentiated liability rules[146].

It should equally be examined whether a total harmonization of liability standards is needed to reach a common market in Europe. Other, useful, but not that far-reaching (less inefficient) instruments may be available. One can think, for example, of a standardization of procedures within environmental law which still remains useful because of the transboundary character of pollution and industrial operations[147]. This can indeed increase transparency, as was intended to be achieved by the IPPC Directive, and can reduce transaction costs. However, such a harmonization should not necessarily be achieved through formal directives, but can also be achieved through a search for common principles through comparative research, looking for a *ius commune*.

In that respect it should be stressed that economic analysis of federalism provides certainly useful insights concerning the question of centralization,

[146] This was rightly suggested by Esty, D. and Geradin, D., 'Market access, competitiveness and harmonization: environmental protection in regional trade agreements', 21 *Harvard Environmental Law Review*, 1997, 291; and Esty, D. and Geradin, D., 'Environmental protection and international competitiveness. A conceptual framework', 32/2 *Journal of World Trade*, 1998, 43.

[147] This is suggested by Esty, D. and Geradin, D., 'Market access, competitiveness and harmonization: environmental protection in regional trade agreements', 21 *Harvard Environmental Law Review*, 1997, 293.

but it does not always provide an answer to the question which of the many possible legal techniques of harmonization has to be chosen to deal with a particular problem. The economic notion of *centralization* is too general to cover all the legal techniques of *harmonization*. It therefore certainly merits further research to find which of these harmonization techniques is best suited to deal with a particular problem like environmental liability. Moreover, in the economic analysis there are unanswered questions which merit further research. One of them is how the need to centralize decision-making in case of transboundary externalities can be reconciled with the ecological goal of a uniform environmental quality. Another is whether industry in heavily polluted areas may be disadvantaged with more stringent emission standards with repect to their competitors in 'cleaner' countries. Some of the questions need further empirical research, for example, concerning the influence of environmental regulation on industry behaviour. In that respect Europe should certainly carefully look at the US experience with environmental federalism[148].

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[148] See for comparative analyses of environmental federalism in the US and Europe e.g. Kimber, Clíona, 'A Comparison of Environmental Federalism in the United States and the European Union', 54, *Maryland Law Review*, 1995; Esty, D. and Geradin, D., 'Market access, competitiveness and harmonization: environmental protection in regional trade agreements', 21 *Harvard Environmental Law Review*, 1997, and Esty, D. and Geradin, D., 'Environmental protection and international competitiveness. A conceptual framework', 32/2 *Journal of World Trade*, 1998; Pfander, J., note 3 (1996) and Rose-Ackerman, S., *Rethinking the Progressive Agenda*, New York, Free Press, 1992, 37–54.

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ANNEX 3.1 POSSIBLE SCOPE OF AN EC ENVIRONMENTAL LIABILITY REGIME